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Reforming the Global Financial Architecture: Is the World a Safer Place?

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Synopsis

Have the policies announced in the aftermath of the global economic crisis (GEC) of 2008-09 and the Asian Financial Crisis (AFC) of 1997-98 been implemented? Has the world become a safer place with a more decentralised financial architecture?

Commentary

THE ASIAN Financial Crisis of 1997-1998 had led to calls for the reform of the international financial architecture or the policies and practices of international economic institutions that promote global financial stability. A large number of policies were proposed for crisis prevention and crisis resolution.

With the faster than expected recovery of the Asian countries after the crisis, however, complacency set in and reforms were either forgotten or abandoned. Complacency partially set the stage for the Global Economic Crisis (GEC) of 2008-2009 although the root causes were regulatory failures in the western countries.

Three reasons for worry

Under the auspices of the newly-created G20, once again, a large number of policies were announced. Have they been implemented and has the world become a safer place? Not much – and for a number of reasons:

The first is complacency, yet again. Five years ago, credit markets were frozen, international trade had fallen off the cliff, and the global economy was headed towards a great depression similar to the one experienced in the 1930s. There was an acute sense of urgency; the major economic powers agreed to coordinate monetary and fiscal policies and "shock and awe" markets. Policy coordination efforts were successful and instead of a global depression the world experienced "the great recession".

Now financial markets no longer pose an immediate systemic threat to the global economy. The global economy is also showing signs of recovery although it is far from healthy, operating well below capacity with millions unemployed in the West. Policy coordination is still very much required, but it is difficult to attain. The G20 which had made substantial progress in global economic reforms during its first three summits – that is, until the Pittsburgh summit - is now headed towards obsolescence. The G20 is moving towards a G-zero!!

Reluctance to reform IMF governance

The second reason for lack of progress in global reforms is the reluctance of the United States to give up its veto power and control in the International Monetary Fund (IMF) which was formed in 1944 by the US with 43 like-minded countries. This club had established the global rules including those for finance. This multilateral rules-based system led to financial stability, rapid expansion of international trade, and unprecedented economic prosperity not only in the members of the club but also in other countries around the world. Among them the so-called BRICS – Brazil, Russia, India, China and South Africa.

Given their growing economic footprint in the world economy, the BRICS desire a greater voice and say in running the IMF. But the club members are loath to give it to them, because, like many other clubs, the IMF is designed to retain firm control in the hands of the founding members. Hence, one of the centrepieces of the proposed global reforms cannot be implemented - namely the G20 pledge to transfer six percent of quota and voting power and two chairs at the IMF Board to large emerging markets.

BRICS without mortar

The third reason for limited progress in reforms is the relatively weak cohesion and coherence within the BRICS. The establishment of the G20 in the aftermath of the GEC has given the BRICS an unprecedented opportunity to sit around the high table with the G7 members and participate in discussions on international economic policies as key stakeholders. However although the BRICS leaders have started to meet ahead of the G20 summit and come up with a statement, many opine that the BRICS are “BRICS without mortar”.

The progress on the proposed BRICS Development Bank and the Contingent Reserve Fund could be also slow as some of the members are now experiencing an economic slowdown. When the position of the managing director of the IMF fell vacant last year, the BRICS failed to stake a claim for the position even though it was well-known that the IMF tradition of locking out non-Europeans would be strongly protected.

For the above reasons, many of the proposed global reforms have not been implemented and the world is not much safer now than it was before the GEC. How the situation might evolve in the future depends on how global politics will play out among the various players.

Possible future scenarios

The GEC has demonstrated beyond doubt that unfettered global markets and greed is a dangerous cocktail that could lead to “elite” capture and insider trading and put global prosperity at risk. A more legitimate multilateral rules-based system is one of the best ways to ensure that the benefits of globalisation are shared in an equitable manner.

Another way is to move to a more decentralised architecture with global and regional institutions working together in a complementary manner. Hopefully, at the end of the day, compromises can be struck between the US and the BRICS and we could move towards either one of these two systems. The world would then become a safer place.

If the US were to shun post-war multilateralism and go for preferential deals with like-minded countries then the global order could fall apart. We would then be back to the “beggar thy neighbour” policies of the 1930s to the detriment of all - including the US and the BRICS.

One dark cloud on the horizon is the keen interest of the US in negotiating the Trans-Pacific Partnership (TPP) and Transatlantic Trade and Investment Pact (TTIP). Regional schemes, if well designed, could be stepping stones to multilateralism. It is hoped that the US’ interest in pursuing these schemes is not to lock out other countries, especially China.

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